MEMORANDUM OF LAW

DATE: January 9, 1996

TO: Mary Rea, Assistant Director, Risk Management

FROM: City Attorney

SUBJECT: Long Term Disability Offsets

QUESTIONS PRESENTED

You have requested legal opinions for two separate questions. Because both questions concern similar issues regarding offsets in the City's Long Term Disability ("LTD") plan, we have responded to both questions in a single memorandum.

Question No. 1:

The facts prompting the first question are as follows. The LTD plan "Coordination of Benefits" clause provides for offsets of "other income." An employee was eligible for disability benefits under both the LTD plan and the City Employees' Retirement System ("CERS"). The employee received LTD plan benefits which were offset by the amount of the disability retirement payments he received. He subsequently paid back the disability retirement monies, opting instead to delay retirement benefits until he is eligible for a service retirement. Under these facts, must the LTD plan administrator refund the retirement monies which previously offset the employee's LTD payments?

Question No. 2:

Under the LTD plan, may the LTD Administrator require eligible employees to apply for, and provide documentation as to eligibility for, Social Security benefits?

SHORT ANSWERS

Answer to Question No. 1:

No. There is no law or public policy in California which prohibits offset provisions in disability plans. The plan's wording appears unambiguous. Since the employee had benefits from both plans available, section 5.01(A)2 of the LTD plan specifically addresses the plan's right to an offset under the plan. The employee's decision to delay receiving the retirement benefits to which he is entitled should not affect the plan's right to an offset. Thus, there is no duty to refund.

Answer to Question No. 2:

Such requirements are permitted by law. However, as the plan is

currently written, such requirements may be subject to challenge because the law indicates such requirements should be clearly articulated in the contract. Under Section 5.05(A)(5), the plan is entitled to an offset for benefits available to eligible employees under the Social Security program. It is reasonable, therefore, for the LTD plan to require employees to apply for benefits and provide the information since the LTD plan and Social Security are mutually exclusive by design. To not provide some enforcement mechanism would defeat the intent and the terms of the LTD plan. The LTD plan should, therefore, be appropriately amended to include language clearly stating eligible employees must apply for, and provide proof of application for, Social Security benefits, thus allowing the plan Administrator to administer the plan in a manner that comports with the original purpose and intent underlying the creation of the LTD plan.

BACKGROUND

The City has an LTD plan which provides employees with a partial income reimbursement when an employee is unable to work due to a temporary disability. The LTD plan provides benefits for up to twelve (12) consecutive months for a total disability. LTD Plan Section 4.03(A). Additionally, if the employee, after the expiration of twelve (12) months, is still unable to engage in any gainful occupation or employment for which the participant is or becomes reasonably fitted by education, training or experience, benefits may be paid until the employee is sixty-five (65) years old if the employee is sixty (60) years old or younger at the time of disability. If the employee is sixty-one (61) years old or older at the time of disability, the benefits are provided for a diminishing number of years depending on the employee's age. LTD Plan Section 5.01(A)(2).

Under the LTD plan, eligible General Member employees are entitled to a benefit of "70% of basic bi-weekly earnings, less all Other Income Benefits" for a specified period of time. LTD Plan Section 5.01(A)(2) (emphasis added). "Other Income Benefits" are defined by the LTD plan to include "income benefits available" as well as benefits actually received. LTD Plan Section 5.05(A). Such benefits include, but are not limited to, Social Security benefits and City Disability Retirement benefits (Coordination of Benefits clause). LTD Plan Section 5.05(A)(4) and (5).

This memorandum will address two situations involving the Coordination of Benefits clause. Specifically, it will address the interaction of eligible employees' benefits. A brief general analysis of offset provisions is provided as offset provisions are central to both issues discussed in this memorandum.

ANALYSIS

I. Offsets Generally are Allowed.

Offsets are defined generally as: "A deduction, a counterclaim, a contrary claim or demand by which a given claim may be lessened or canceled." Black's Law Dictionary, 1085 (6th ed. 1990). The underlying purpose of offsets is to ensure a beneficiary receives all the benefits to which he or she is entitled, without duplication of payment which might result in overpayment. As a general rule, a primary benefit source may be reduced by an offset of the benefits received from secondary sources. Not all secondary benefits are subject to offset. For example, a privately purchased disability plan would not be used to reduce LTD benefits through an offset. However, statutory and case law in California generally permit offsetting from disability benefits similar benefits from other sources, and some statutes specifically allow for offsets in other types of related insurance.

For example, state law allows an offset of uninsured motorist insurance benefits to the extent of benefits paid under medical payments coverage. Cal. Ins. Code Section 11580.2(e) (West 1977). Additionally, California law allows for group disability policies to "among other things," reduce benefits where "the individual insured has any other coverage (other than individual policies or contracts) providing hospital, surgical or medical benefits . . . ." Cal. Ins. Code Section 10270.98. Similarly, California Insurance Code section 10127.1 exempts Social Security benefit increases from contractual offset provisions in disability policies.

From these specific statutory exemptions for certain types of offsets, coupled with case law allowing offsets generally, an approval of offsets in disability policies may be inferred. Courts have frequently stated: "[i]t is assumed that the Legislature has in mind existing laws when it passes a statute." Cumero v. Public Employment Relations Bd., 49 Cal. 3d 575, 596 (1989). Thus, since the cited statutes which allow offsets have been before the legislature on several occasions, without challenge or change, we may presume offsets are permissible. The courts note that "[t]he failure of the Legislature to change the law in a particular respect when the subject is generally before it and changes in other respects are made is indicative of an intent to leave the law as it stands in the aspects not amended." Id.

The courts' too, have considered and allowed offsets to stand. For example, in Union Mutual Life Ins. Co. v. Kinder, 108 Cal. App. 3d 517 (1980), the court interpreted the effect of California Insurance Code section 10127.1 on long term disability policies which offset Social Security benefits. The court never questioned the validity of the offset provision itself, merely whether the company could continue in force its existing policies which did not freeze the Social Security offset.

Additional support for offset provisions may be found in the federal arena. The federal Social Security Act contains an offset

provision for certain worker's compensation and disability "benefits payable (and actually paid)." 42 U.S.C. Section 424(a)(4). Also, the Supreme Court upheld the constitutionality of the worker's compensation offset in Richardson v. Belcher, 404 U.S. 78 (1971). Thus, both federal and state law allow for offset provisions.

In those instances where courts have found certain offset clauses to be invalid, it has generally been because the contract provision was found to be vague. See, e.g., Wheeler v. Board of Admin. of Pub. Employees' Retirement Sys., 25 Cal. 3d 600 (1979) (interpreting a PERS disability offset for benefits the employee was "entitled to receive" from Social Security as those he actually received after Social Security offset his worker's compensation benefit); Burkett v. Continental Casualty Co., 271 Cal. App. 2d 360 (1969) (interpreting offset "paid or pay-able" as not requiring insured to apply for worker's compensation benefits); Connecticut Gen. Life Ins. Co. v. Craton, 405 F.2d 41 (5th Cir. 1968) (benefits under a union mutual benefit fund could not be offset as not a "union welfare plan" or "employee benefit plan" as under the contract); Kates v. St. Paul Fire & Marine Ins. Co., 509 F.Supp. 477 (D. Mass. 1981) (court struck down a provision for public policy reasons where, if the insured were to receive both Social Security and worker's compensation, the offset would always mean no benefit from the policy would be paid); Time Ins. Co. v. English, 391 So.2d 768 (Fla. Dist. Ct. App. 1980) (disallowing offset for federal worker's compensation benefits because not for "loss of time" as required under the contract); Mays v. Insurance Co. of N. Am., 284 N.W.2d 256 (Mich. 1979) (clause reducing benefits payable to the insured even if the insured failed to apply for them, interpreted to modify only Social Security benefits and not worker's compensation); Barnett v. Aetna Life Ins. Co., 723 S.W.2d 663 (Tex. 1987) (V.A. benefits not offset because not similar to Social Security, Railroad Retirement, or worker's compensation benefits specifically included in the contract).

The courts' attention to vagueness in these cases is due in part to the fact that the policies at issue were commercial insurance products. In California (and other states), a long line of cases has held that where an insurance policy is ambiguous, that is, is capable of more than one reasonable interpretation, "contract interpretation required it be construed in the insured's favor, according to his reasonable expectations." Montrose Chem. Corp. v. Superior Court, 6 Cal. 4th 287, 299 (1993). To the extent that the policies were not vague, offset provisions have generally been upheld. See, e.g., Wheeler, 25 Cal. 3d 600; Union Mut. Life Ins. Co., 108 Cal. App. 3d 517; Bailey v. Interinsurance Exch. of the Auto. Club of S. Cal., 49 Cal. App. 3d 399 (1975).

While this discussion of statutory offsets does not specifically apply to the City's LTD and CERS plan offset provisions, since those

plans apply to City employees only, it does indicate that California law does not disapprove of offsets generally. Thus, in responding to the two questions presented we start with the premise that the offset provisions of the LTD plan are legally sound. With this analysis as background, we may now address the specific questions you have put forth.

II. The Plan Administrator is not Required to Repay Monies Originally Offset Because of Retirement Disability Benefits

This question has arisen as a result of a case involving a former employee. The employee retired on a non-industrial disability on May 22, 1993. He was entitled to, and received, benefits under the LTD plan. He also applied for, and received, benefits to which he was entitled under the City's Disability Retirement Plan. He received a total of $9,042.56 from the retirement fund between May 1993 and May 1995. Because of the LTD plan's Coordination of Benefits clause, his LTD benefit was correspondingly reduced by $8,923.26 during that period.

On November 18, 1994, the Retirement Board accepted a request from the employee to convert his pension from a non-industrial disability retirement to a deferred service retirement when he reaches age 62. In June 1995, the employee reimbursed the retirement fund the full amount of benefits he received. He is now requesting the LTD Administrator refund the monies reduced from his LTD benefits as a result of his receipt of retirement disability benefits. For the reasons set forth below, the Administrator is not required by law to refund the offset which was lawfully taken.

Under the terms of the LTD plan, eligible General Member employees are entitled to a benefit of "70% of basic bi-weekly earnings, less all Other Income Benefits" for a specified period of time. LTD Plan Section 5.01(A)(2) (emphasis added). "Other Income Benefits" are defined in Section 5.05 of the plan:

> SECTION 5.05 OTHER INCOME BENEFITS
>
> (A) The term "Other Income Benefits" as used in Section 5.01 refers to income benefits available under the following conditions:
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> . . . .
>
> (4) any disability benefit, under a retirement program to which the City or other employer makes contributions;
>
> . . . .
>
> (9) any service retirement benefits under a City of San Diego retirement program to which the employer makes contributions;
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> . . . .

LTD Plan Section 5.05 (emphasis added).

The unambiguous language of the LTD plan provides that the benefit

is determined by taking the "basic bi-weekly earning" level and deducting "Other Income Benefits" that are "available" to the employee. "Available" is defined as: "Suitable; useable; accessible; obtainable; present or ready for immediate use.
Having sufficient force or efficacy; effectual; valid." Black's Law Dictionary 123 (5th ed. 1979). No California statute or case law exists to interpret when a benefit is "available" to a beneficiary. In fact, in only one case since 1966 has the word "available" been used in conjunction with disability insurance offset provisions in any jurisdiction. In that case, the court found that benefits paid to the claimant's former wife on behalf of the claimant's son were "benefits 'available to him' as provided in the policy." The court found the benefits to be "available" even though his son was in the custody of the claimant's former wife and he was no longer obligated to pay child support. Sweet v. Traveler's Ins. Co., 492 So. 2d 240, 242 (La. Ct. App. 1986). Thus, the only case addressing "available" allows a very broad interpretation and use of the word. The effect of these definitions is self-evident: if an employee has access to a benefit, whether or not the benefit is actually obtained, the benefit must be offset.

The terms and conditions of the LTD plan are incorporated by reference in the Memoranda of Understanding ("MOU") with each of the City's labor organizations. Because the MOUs are the City's employment agreements with its employees, we may safely look to general rules of contract interpretation for guidance in determining the intent of the LTD plan. In doing so, we find that:

> It is a basic principle of insurance contract interpretation that doubts, uncertainties and ambiguities arising out of policy language ordinarily should be resolved in favor of the insured in order to protect his reasonable expectation of coverage. It is also well established, however, that this rule of construction is applicable only when the policy language is found to be unclear. A policy provision is ambiguous when it is capable of two or more constructions, both of which are reasonable. Whether language in a contract is ambiguous is a question of law. We are also guided by the principle that words in an insurance policy must be read in their ordinary sense, and any ambiguity cannot be based on a strained interpretation of the policy language.

Producers Dairy Delivery Co. v. Sentry Ins. Co., 41 Cal. 3d

903, 904 (1986) (citations omitted, emphasis in original).

Here, because the City is the drafter of the LTD plan, any ambiguities in the language should be resolved in the employee's favor. However, the language, read in its "ordinary sense," is capable of only one reasonable interpretation as set forth above.

Thus, under the ordinary meaning of the word, the disability retirement benefits were "available" to the employee as of May 22, 1993. This premise is irrefutable because he did, in fact, receive them. It was the employee's personal choice to discontinue his retirement benefit and to return the monies he had already received. In no sense does this decision by the employee make the benefits less "available" to him.

In drafting the Coordination of Benefits clause, the LTD plan anticipated certain specific types of other benefits which might also be available to an employee eligible for LTD. Among the anticipated benefits listed as being subject to offsets in Section 5.05 was the City's retirement program, both in its disability provisions (Section 5.05(4)) and its service retirement provisions. (Section 5.05(9)). The purpose of the LTD plan is to provide a certain level of the employee's pre-disability income. Other benefits may overlap with LTD, since they have similar objectives; that is, providing a disabled employee with income protection. The Coordination of Benefits clause in the LTD plan was written to anticipate overlapping benefits and to keep the LTD benefit level at 70% of earnings. No other reasonable interpretation of the plain language of the clause exists. Section 5.01(4)(2) unambiguously provides "the Long Term Disability benefit is 70% of basic bi-weekly earnings, less all other income benefits" (emphasis added). The offset monies need not, therefore, be returned.

III. The LTD Administrator May Require Eligible Employees to Apply for, and Provide Documentation Eligibility for, Social Security Benefits.

A. Requiring Application

The LTD plan does not specifically delineate an employee's responsibility to apply for Social Security benefits and does not, therefore, meet the explicit requirements of the Burkett case. However, the plan includes a Coordination of Benefits clause which specifically allows for offsets of Social Security benefits. Included in the definition of Other Income Benefits in Section 5.04(e) is:

> (5) 100% of the primary and family insurance amount under the Federal Social Security Act or the Railroad Retirement Act, as in effect on the date of total disability commenced, on account of the Participant's disability. Automatic increases in any such benefits after the date the

> total disability commenced shall not affect the amount of disability benefit payable under this Plan;

LTD Plan Section 5.04(e).

The 100% offset for Social Security benefits and the provision allowing no change in benefits for automatic increases anticipates an eligible employee's application for benefits. Similar application requirements have been previously addressed by the courts, but California case law is sparse and mixed on the issue of whether an insurer can require an insured to apply for benefits which will be offset under a disability policy. In Burkett, 271 Cal. App. 2d 360, the court examined an insurance policy which provided for an offset of worker's compensation payments "paid or payable." The plaintiff did not apply for benefits and the company reduced his benefits by an amount an expert witness testified he would have received from worker's compensation had he applied. The court held the offset was improper because the language of the policy was vague. "[T]he policy does not contain any statement of an obligation on the part of the insured to apply for workmen's compensation." Id. at 362. The court also indicated that "[o]ne who purchases a disability insurance policy need not take proceedings to relieve his insurer by seeking other remedies, unless the policy clearly obliges him to do so." Id. at 363.

What is sufficient language to "clearly oblige" the insured was dealt with six years later in Bailey v. Interinsurance Exch. of the Auto. Club of S. Cal., 49 Cal. App. 3d 399 (1975). The policy language in Bailey was "either payable or required to be provided under any workmen's compensation law." Id. at 402. The court found the difference in language sufficiently compelling to justify a different outcome.

> "[P]ayable" standing alone might be ambiguous. [c]iting Burkett. However, the additional language "or required to be provided under any workmen's compensation law" creates an exclusion which is susceptible of only one reasonable and logical interpretation. That interpretation is that the policy excludes coverage for an injury for which the insured is eligible for workmen's compensation benefits. The plaintiff's voluntary decision not to seek those benefits cannot expand the insurer's liability under the contract of insurance.

Id. at 404.

The case law from other jurisdictions is no more enlightening. See, e.g., Coughlin v. Connecticut Gen. Life Ins. Co., 330 A.2d 159 (Del. Super. Ct. 1974) (court found no offset for worker's compensation benefits where the insured was not entitled to them as a matter of law); Toppi v. Prudential Ins. Co., 379 A.2d 1300, 1303 (N.J. Super. Ct. 1977) (court did not allow an insurer to withhold an estimated temporary disability benefit from personal insurance protection (PIP) benefits, but did allow the insurer to apply directly for the benefits in the insured's name).

However, the question presented is not whether the LTD plan has a right to offset the Social Security benefits an eligible participant receives, but whether the plan may require an employee to apply for Social Security benefits. The Burkett case indicates such a requirement is permissible if the requirement is stated in the contract in clear unambiguous language. Since the LTD Plan is designed to replace Social Security benefits and the two plans are therefore mutually exclusive, the requirement is permissible. However, because the LTD Plan does not specifically require application for Social Security to be made, it does not comport with the Burkett holding and should be amended.

B. Requiring Documentation

The second part of your question asks whether the City may require documentation showing an employee has applied for, and been granted or denied, benefits from Social Security. This is a question which should not arise very often. The City opted out of the Social Security system in 1982. Thus, the only employees who will be eligible for Social Security benefits will have earned them with creditable quarters of service either before 1982, or with another employer. The LTD program was designed as part of a system to provide protection for workers who would not be eligible for Social Security disability benefits. The underlying basis for the LTD plan would, therefore, indicate that requiring documentation of application for Social Security documentation is a reasonable method of ensuring the integrity of the plan.

The requirement of providing documentation only serves to verify that no duplication of benefits is taking place. Such a duplication would clearly violate the terms of the LTD plan. It would defeat a central purpose of the LTD plan in general, that is, to replace Social Security for ineligible employees, and would defeat the central purpose of the Coordination of Benefits clause in particular.

C. Recommendation

Since the case law is not especially clear, it would be prudent for the LTD plan to be amended to more clearly set out the employee's obligation to provide documentation of application and eligibility for Social Security benefits in compliance with the dictates of the Burkett case. As an example, the Social Security Act provides in pertinent

part:

> If it appears to the Secretary that an individual may be eligible for periodic benefits under a law or plan which would give rise to reduction under this section, he may require, as a condition of certification for payment of any benefits . . . that such individual certify (i) whether he has filed or intends to file any claim for such periodic benefits, and (ii) if he has so filed, whether there has been a decision on such claim. The Secretary may, in the absence of evidence to the contrary, rely upon such a certification . . . in certifying benefits for payment . . . .

42 U.S.C. Section 424a(e).

Such language makes clear the type of documentation an individual must submit prior to being granted Social Security benefits. To bring the LTD plan in compliance with the Burkett case, similar language should be added to the plan by amendment. A more clear statement of intention to require certification might help to further clarify the relationship between the LTD plan and Social Security, and avoid confusion to beneficiaries when the request is made.

CONCLUSION

In general, the courts do not view offsets with hostility. When provisions are clear and unambiguous, they are enforced. The plan's Coordination of Benefits clause appears to be clear and unambiguous, susceptible to only one reasonable interpretation. If benefits listed in Section 5.05 of the plan are available to the employee, the Administrator may properly reduce the LTD payments to the extent of the overlap.

The LTD plan may provide that eligible employees apply for, or provide proof of application for, Social Security Benefits. However, the LTD plan must be amended to allow such requirements to be imposed. If such language were included, the LTD Administrator would be acting reasonably by requiring LTD recipients to furnish evidence they are not also eligible to receive Social Security benefits. If they are eligible, the Administrator may reduce their benefits accordingly since the two programs are mutually exclusive by design.

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